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INT-05 L-02 NSAE-00 NSC-05 OMB-01 PM-03 RSC-01 SAM-01

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FM US MISSION EC BRUSSELS

TO SECSTATE WASHDC 7881

INFO ALL EC CAPITALS 88

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C O N F I D E N T I A L SECTION 1 OF 2 EC BRUSSELS 9225

E.O. 11652: GDS

TAGS: EFIN, EEC

SUBJECT: EC COMMISSION ASSESSES IMPACT OF ENERGY CRISIS

REF: EC BRUSSELS 8988

1. SUMMARY: THE EC COMMISSION'S ANALYSIS OF THE IMPACT OF THE ENERGY CRISIS INDICATES THAT SEVERAL MEMBER STATES WOULD FACE A POLITICALLY AND SOCIALLY INTOLERABLE SITUATION SHOULD THEY ATTEMPT TO OBTAIN EQUILIBRIUM IN THEIR BOP POSITIONS BY THE END OF 1978. CONSEQUENTLY THE COMMISSION FORESEES THE NEED FOR SUBSTANTIAL FINANCIAL SUPPORT TO THESE HARD-PRESSED COUNTRIES OVER AN EXTENDED PERIOD. THIS IS NOT AN INSOLUBLE PROBLEM BUT WILL REQUIRE EC COOPERATION, ESPECIALLY FINANCIAL ASSISTANCE FROM THE FRG. END SUMMARY.

2. FOLLOWING UP ON ITS REVISED ASSESSMENT (REFTEL) OF THE COMMUNITY'S ECONOMIC SITUATION, THE COMMISSION IS NOW PREPARING A MORE DETAILED ANALYSIS OF THE IMPACT OF THE ENERGY CRISIS. THIS ANALYSIS WILL BE USED IN THE
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EC COUNCIL'S FORTHCOMING REVIEW OF THE COMMUNITY'S

ENERGY PROGRAM AND IN ABBREVIATED FORM WILL BE USED AS PART OF THE BACKGROUND PAPERS FOR THE SUMMIT CONFERENCE. AS REPORTED, THE COMMISSION BELIEVES THAT THE EC AS A WHOLE MUST REDUCE ITS OTHERWISE POSSIBLE CUMULATIVE GNP GROWTH BY 4 PERCENTAGE POINTS BETWEEN 1974-1978, I.E. INSTEAD OF A CUMULATIVE REAL GROWTH OF ABOUT 18-20 PERCENT FROM 1974 TO 1978, IT WOULD EXPERIENCE ONLY 14-16 PERCENT. ON A CONFIDENTIAL BASIS THE COMMISSION HAS PROVIDED US WITH THE FOLLOWING ESTIMATE OF HOW THIS REDUCTION IN REAL GNP GROWTH SHOULD BE DISTRIBUTED AMONG THE MEMBER STATES: GERMANY, 1-1.5 PERCENT; FRANCE, 4 PERCENT; ITALY, 8-9 PERCENT; THE UK, 8-9 PERCENT; IRELAND, 13-14 PERCENT; DENMARK, 6-7 PERCENT; THE NETHERLANDS, 0-1 PERCENT; AND BELGIUM/LUXEMBOURG, 0-1PERCENT.

3. ON THE BASIS OF THIS ANALYSIS, COMMISSION OFFICIALS CONCLUDE THAT IT WOULD BE IMPOSSIBLE FOR ITALY, THE UK, IRELAND AND PERHAPS DENMARK TO MAKE THE NECESSARY ADJUSTMENTS BY THE END OF 1978. ATTEMPTING TO REDUCE GNP GROWTH SO RAPIDLY WOULD CREATE INTOLERABLE POLITICAL AND SOCIAL PROBLEMS. FOR EXAMPLE, IF IT IS TO CARRY OUT NECESSARY INVESTMENT ACTIVITIES, ITALY WOULD HAVE TO REDUCE PRIVATE CONSUMPTION BY 12 PERCENT FROM WHAT IT WOULD OTHERWISE BE IN 1979, I.E., HOLD PRIVATE CONSUMPTION TO ABOUT A 1 PERCENT AVERAGE ANNUAL REAL GROWTH RATE UNTIL 1979. COMMISSION OFFICIALS FORESEE THE NEED TO EXTEND BEYOND 1978 THE ADJUSTMENT PROCESS OF THESE HARD-PRESSED COUNTRIES. THIS WILL REQUIRE SUBSTANTIAL FINANCIAL SUPPORT TO EASE THEIR BALANCE OF PAYMENTS PROBLEMS, THEREBY LENGTHENING THE ADJUSTMENT PERIOD. THE STUDY IMPLIES THAT THESE ADJUSTMENTS WILL ALSO REQUIRE SUBSTANTIAL CHANGES IN THE EXCHANGE RATES OF THE MOST SERIOUSLY AFFECTED MEMBER STATES.

4. THE COMMISSION'S STUDY MAKES THREE ASSUMPTIONS REGARDING THE PRICE OF OIL FROM 1974-78. THESE ARE: 1) HI--THE PRICE OF OIL REMAINS CONSTANT IN NOMINAL TERMS; IT USES A PRICE OF \$10.50 PER BARREL AS THE BASE
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PRICE; 2) H2-- THE BASE PRICE WILL BE MAINTAINED IN REAL TERMS, I.E., IT WILL BE ADJUSTED

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UPWARD AT THE RATE OF INFLATION WHICH IS PROJECTED TO BE 8 PERCENT PER YEAR; AND 3) H3--THE BASE PRICE WILL INCREASE 16 PERCENT ANNUALLY. THE REQUIRED GNP ADJUSTMENTS LISTED ABOVE ARE BASED ON THE FIRST HYPOTHESIS (H1).

5. THE FOLLOWING TABLE IS THE COMMISSION'S ESTIMATE OF THE CUMULATIVE IMPACT OF THE INCREASED PRICE OF OIL FROM 1974-78:

BILLIONS OF CURRENT DOLLARS)

	H1	H2	H3
PETROLEUM REVENUE OF THE OPEC, 1974-78			
TOTAL WORLDWIDE	542.0	641.4	767.2
OF WHICH THE EC CONTRIBUTES	203.62	242.9	288.46
OPEC COUNTRIES' IMPORTS, 1974-78			
TOTAL WORLDWIDE	297.5	346.7	406.1
OF WHICH ORIGINATE FROM THE EC	126.5	147.3	172.7
NON-ABSORBED PETROLEUM REVENUES OF OPEC			
TOTAL WORLDWIDE	244.5	294.7	361.1
OF WHICH THE EC SHARE IS	77.12	94.7	115.76

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6. FROM THESE ESTIMATES AND TAKING INTO ACCOUNT PROJECTED TRADE SURPLUSES WITH NON-OPEC COUNTRIES, THE EC ESTIMATES THE CUMULATIVE CURRENT ACCOUNT DEFICIT UNDER ASSUMPTION H1 COULD REACH \$60 BILLION BY THE END OF 1978 (REFTEL). ADDING IN INTEREST CHARGES, THE DEFICIT COULD REACH \$66 TO 72 BILLION. THE COMMISSION DOES NOT CONSIDER THIS TO BE AN INSOLUBLE PROBLEM BUT IT OBVIOUSLY CALLS FOR JOINT ACTION. WHEN ASKED WHY THEY DID NOT INCLUDE AN ASSUMPTION OF A LOWER PRICE OF OIL, COMMISSION OFFICIALS SAID THEY DID NOT BELIEVE THE PRICE WOULD COME DOWN IN THE FORESEEABLE FUTURE. THEY ADDED THAT THE KEY TO SOLVING THIS PROBLEM WAS GERMANY'S WILLINGNESS BOTH TO EXPAND ITS ECONOMY AND TO PROVIDE SUBSTANTIAL FINANCIAL SUPPORT TO THE HARD-PRESSED MEMBER STATESM

7. COMMENT: THE COMMISSION'S ANALYSIS OF THE OVERALL IMPACT OF THE INCREASED PRICE OF OIL, PARTICULARLY THE TABLE REPORTED IN PARAPGRAPH 5, WILL BE SUBMITTED TO THE EC COUNCIL. THE ESTIMATED DISTRIBUTION OF THIS IMPACT, HOWEVER, IS PART OF AN INTERNAL WORKING DOCUMENT THAT WILL BE HELD WITHIN THE FINANCIAL DIRECTORATE OF THE COMMISSION.END COMMENT. MYERSON

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